No. 14574

In the United States Court of Appeals for the Ninth Circuit

STEPHEN F. HERINGER, MABEL H. HERINGER, JOHN F. HERINGER, and ALTA G. HERINGER, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The findings of fact and the opinion of the Tax Court (R. 84-89) are reported at 21 T. C. 607.

JURISDICTION

The petition for review (R. 96-113) involves gift tax deficiencies for 1948 and 1949.[1] Notices of deficiencies

[1] The amounts involved are as follows (R. 90-93):

Taxpayer	*Year*	*Deficiency*
Stephen F. Heringer	1948	$ 15,353.28
Stephen F. Heringer	1949	17,365.59
Mabel H. Heringer	1948	4,784.76
Mabel H. Heringer	1949	16,221.41
John F. Heringer	1948	15,353.28
John F. Heringer	1949	17,365.59
Alta G. Heringer	1948	4,784.76
Alta G. Heringer	1949	16,221.41
Total		107,450.08

covering all of the taxes were mailed to the respective taxpayers on January 17, 1952. (R. 11-15.) [2] On April 11, 1952, the taxpayers filed with the Tax Court petitions for redetermination, under the provisions of Section 272 of the Internal Revenue Code of 1939. (R. 3, 5-10.) The decisions of the Tax Court were entered on June 11, 1954. (R. 90-93.) The cases are brought to this Court by a consolidated petition for review filed on August 9, 1954. (R. 96-113.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

1. Whether the Tax Court correctly held that the transfers of property to a corporation by four individuals who were 40 percent stockholders in the corporation were gifts, under Section 1000 of the Internal Revenue Code of 1939.

2. Whether the Tax Court correctly held that the gifts were made to the corporation (with one annual exclusion to each taxpayer) and not to the remaining 60 percent of the non-contributing stockholders, the taxpayers' children.

3. Whether the Tax Court correctly held that the gifts were taxable to the full extent of their value, without diminution to the extent of the increase in value of the shares held by the donors.

STATUTE INVOLVED

Internal Revenue Code of 1939:

Sec. 1000. Imposition of Tax.

(a) For the calendar year 1940 and each calendar year thereafter a tax, computed as provided in

[2] By stipulation, the transcript of record on appeal contains the pleadings in the Tax Court of only one of the taxpayers.

section 1001, shall be imposed upon the transfer during such calendar year by any individual, resident or non-resident, of property by gift. Gift taxes for the calendar years 1932-1939, inclusive, shall not be affected by the provisions of this chapter, but shall remain subject to the applicable provisions of the Revenue Act of 1932, except as such provisions are modified by legislation enacted subsequent to the Revenue Act of 1932.

(b) The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; but, in the case of a non-resident not a citizen of the United States, shall apply to a transfer only if the property is situated within the United States.

(26 U. S. C. 1952 ed., Sec. 1000.)

Sec. 1002. Transfer for Less Than Adequate and Full Consideration.

Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall, for the purpose of the tax imposed by this chapter, be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

(26 U. S. C, 1952 ed., Sec. 1002.)

SEC. 1003. NET GIFTS.

*   *   *   *   *

(b) *Exclusions from Gifts.*

*   *   *   *   *

(3) [as added by Section 454, Revenue Act of 1942, c. 619, 56 Stat. 798] *Gifts after 1942.*—In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year 1943 and subsequent calendar years, the first $3,000 of such gifts to such person shall not, for the purposes of subsection (a), be included in the total amount of gifts made during such year.

(26 U. S. C. 1952 ed., Sec. 1003.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

(1) *Person.*—The term "person" shall be construed to mean and include an individual, a trust, estate, partnership, company, or corporation.

*   *   *   *   *

(26 U. S. C. 1952 ed., Sec. 3797.)

STATEMENT

Some of the facts have been stipulated. (R. 18-22.) The additional findings of the Tax Court are as follows:

Stephen F. Heringer and John F. Heringer are brothers. Their respective wives are Mabel H. Heringer and Alta G. Heringer. These four persons

(referred to as the taxpayers) together owned approximately 2,074 acres of farm land in Sacramento County, California. (R. 85-86.)

On January 5, 1948, Vorden Farms, Inc. (referred to as the corporation) was organized to conduct a farming and agricultural business. On December 8, 1948, the corporation issued to the taxpayers and members of their two families 50,000 shares of stock at $1 per share in exchange for $50,000 in cash. The two families consisted of the taxpayers and their eleven children. Each of the 15 shareholders separately purchased the following amount of stock (R. 86):

	No. of shares
Stephen F. Heringer	5,000
Mabel H. Heringer	5,000
Frederick J. Heringer	2,500
Wilfred R. Heringer	2,500
Lester S. Heringer	2,500
James T. Heringer	2,500
Robert P. Heringer	2,500
Richard T. Heringer	2,500
John F. Heringer	5,000
Alta G. Heringer	5,000
Donald S. Heringer	3,000
John F. Heringer, Jr.	3,000
Genette Heringer	3,000
George Heringer	3,000
Ned Heringer	3,000

On December 14, 1948, a directors' meeting was held and officers were elected. On December 28, 1948, the taxpayers conveyed to the corporation an aggregate undivided one-half interest in the 2,074 acres owned by them. On January 5, 1949, they conveyed the re-

maining acreage to the corporation. The fair market value of the total acreage was $641,443. At special meetings of the board of directors held on December 24, 1948, and January 3, 1949, resolutions were adopted accepting the realty contributions. It was explained at these meetings that the contributions would have the effect of benefitting the 11 noncontributing shareholders to the extent of their proportionate interests in the corporation. (R. 87.)

Prior to the incorporation of Vorden Farms, Inc., the taxpayers had leased the acreage in question to a partnership known as Vorden Farms, all of the members of which were children of the taxpayers. The corporation leased the land to a partnership of the same designation, comprising nine of the eleven children. The partnership actually engaged in farming the land. The corporation held title to the land, collected the rents, paid taxes and reclamation assessments, and distributed dividends. It paid salaries to its officers. (R. 36-37, 87-88.)

Each of the taxpayers filed gift tax returns for 1948 and 1949, respectively. The returns stated that the transfers of the acreage to the corporation were not gifts, and that if they were gifts, the donors retained a 40 per cent interest in the property transferred and each donor was entitled to 11 exclusions for gift tax purposes, determined by the number of the non-contributing stockholders. (R. 88.)

The Commissioner determined and the Tax Court held that the transfers were gifts to the corporation measured by the entire value of the land, and that each of the taxpayers was entitled to only one exclusion for each year. (R. 88.)

SUMMARY OF ARGUMENT

In holding that the transfers of property to Vorden Farms, Inc. by the taxpayer-donor-40 per cent stockholders in the corporation were *gifts* in their *entirety* to the corporation—and not, in part, to the taxpayers' children who were the remaining 60 per cent stockholders—and that, consequently, the taxpayers were each entitled to only *one annual exclusion* for gift tax purposes, the decisions below are correct on their facts and embody a proper application of established principles. The transfers were intended as gifts; and even if it is assumed, *arguendo,* that there was no donative intent, the record nevertheless fails to show that the transfers were made for an adequate and full consideration in money or money's worth. The transfers were made to the corporation alone, which, as a separate and distinct entity, engaged in business, could not be disregarded for tax purposes as a mere mechanical conduit for its stockholders. The transfers thus were gifts to a single entity, entitling the taxpayer-donors to only one exclusion each for each taxable year. If, on the taxpayer's hypothesis, the non-contributing stockholders were the intended beneficiaries of the transfers (to the extent of their 60 per cent interest in the corporation), their interests, in any event, would have been future interests, and no exclusions would have been allowed. The taxpayers divested themselves of all control over and interest in the property, in favor of the corporation, and the benefit to the non-contributing stockholders was indirect and derivative. The measure of the gifts was therefore the full value of the property in the hands of the taxpayer-donors.

ARGUMENT

I

The Transfers of the Acreage Were Gifts

Vorden Farms, Inc., was incorporated on January 5, 1948. All of the stockholders (the four taxpayers and their eleven children) paid in $50,000 for the 50,000 shares of stock which were issued in December of that year. This contribution to capital was obviously supported by valuable consideration and was therefore excluded from the gift category. But the same conclusion may not be drawn with respect to the 2,074 acres which the taxpayers alone transferred to the corporation on two occasions approximately a year after the incorporation. Those transfers were made with donative intent. And even if it be assumed, *arguendo,* that the taxpayers had no donative intent, the transfers were not supported by "adequate and full consideration in money or money's worth * * *." Section 1002, Internal Revenue Code of 1939, *supra.* Accordingly (Cf. *Commissioner* v. *Wemyss,* 324 U.S. 303; *Merrill* v. *Fahs,* 324 U.S. 308, rehearing denied, 324 U.S. 888; *Horst* v. *Commissioner,* 150 F. 2d 1 (C. A. 9th), certiorari denied, 326 U.S. 761), they were gifts—whether regarded as gifts to the corporation, as the Tax Court held, or as gifts to the noncontributing stockholders, as the taxpayers alternatively contend. (Br. 22-23.)

The record does not show what consideration, if any, was given for the transfers of the acreage. On the contrary, the testimony on this aspect of the case supports the Tax Court's conclusion that the transfers were gifts. Thus, Stephen F. Heringer, one of the taxpayers was asked (R. 31)—

> what if any intention went on in your mind, or the purpose for which you made this transfer of the Pearson District property to this corporation in 1948 and '49? Why did you do it?

He replied (R. 31):

> We wanted to keep it in one piece, and we thought probably the boys would farm it more successfully if they had an interest in it.

Similarly, John F. Heringer, another of the taxpayers, stated as his reason for transferring the property (R. 38):

> Well, I thought that we needed the boys' help, and was trying to retain it.[3]

The foregoing, which comprises all of the oral testimony with respect to intent and consideration, reveals no consideration flowing to the taxpayers, either from the corporation or from the non-contributing stockholders. The latter did not contractually obligate themselves, because of the transfers, to remain in the business of farming or to do anything that they were not otherwise obligated to do. At the most, the oral testimony merely demonstrates that there was a *business reason* for the transfers, and the same may be said with respect to the documentary evidence upon which the taxpayers rely—

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[3] Frederick J. Heringer, one of the non-contributing stockholders, was asked by counsel for the taxpayers (R. 65):

> When you received an increase in value of your shares by virtue of the contribution of capital to the corporation by the four senior Heringers, did you regard it as something that you received for nothing?

The Tax Court sustained an objection to the question on the ground that it stated facts not of record in the proceeding.

in the main, the explanation in the corporate records that (R. 87) "the effect of the contribution[s] would be to benefit the 11 non-contributing shareholders to the extent of their proportionate interests in the corporation." But this explanation appears far more consistent with the hypothesis of gift than of consideration, since it merely reflects the expectation that as a result of the transfers, the non-contributing stockholders would become more firmly dedicated to the farming enterprise to the mutual benefit of all concerned. But, as one author has stated (II Paul, Federal Estate and Gift Taxation, Sec. 16.06) "the concept [of gift] has in many cases been identified with transfers not supported by consideration, where *reasons of business* were involved." (Emphasis added.) Thus, in *Helvering* v. *Amer. Dental Co.,* 318 U.S. 322, 331, where a cancellation of indebtedness was held to constitute a gift to the debtor, the Supreme Court stated:

> The fact that the *motives* * * * *were those of business* or even selfish * * * is not significant. The forgiveness was gratuitous, a release of something * * * for nothing, and sufficient to make the cancellation here gifts within the statute. (Emphasis added.)

Whether a transfer constitutes a gift is a purely factual issue, as this Court has observed in *Pacific Magnesium, Inc.* v. *Westover,* 183 F. 2d 584. See also *Commissioner* v. *Jacobson,* 336 U.S. 28, 51. Contrary to the taxpayers' contention (Br. 21), the record in this case demonstrates the existence of all the elements which would qualify the transfers as valid gifts. There were competent donors, a proper subject matter, a donative

intent (or the absence of adequate consideration in money or money's worth), the delivery of the acreage to a competent donee, the absence of any power in the taxpayer-donors to revoke or repossess it or to exercise any dominion or control over it (except indirectly, as minority stockholders), and acceptance of the acreage by the donee-corporation. II Montgomery's Federal Taxes, Corporations, and Partnerships (1951-52), pp. 965-966. Thus, it cannot be said that the Tax Court's conclusion that the transfers were gifts—regardless of the identity of the donees—was clearly erroneous, and it should therefore be sustained. Rule 52(a), Federal Rules of Civil Procedure; *United States* v. *Gypsum Co.,* 333 U.S. 364, 394-395, rehearing denied, 333 U.S. 869. Furthermore, the Tax Court's conclusion that the transfers here were gifts accords with the intent of Congress to use the term "gifts" in the broadest and most comprehensive sense. *Commissioner* v. *Wemyss, supra*, p. 306; *Smith* v. *Shaughnessy,* 318 U.S. 176, 180; *Commissioner* v. *Beck's Estate,* 129 F. 2d 243, 344 (C.A. 2d). Finally, it is significant that the summation of the taxpayers' argument (Br. 20-24) goes far toward conceding that the transfers *were gifts* albeit alleged gifts to the non-contributing stockholders.

In *Thompson* v. *Commissioner,* 42 B.T.A. 121, upon facts similar to those of the instant case, the taxpayer, a 50 per cent stockholder in a corporation in which the remaining stock was held by or on behalf of his wife and children, claimed, among other things, that certain transfers of cash and securities which he made to the corporation were contributions of paid-in surplus and not gifts. In holding that the transfers were gifts, the

Board stated, in language appropriate to the instant case (pp. 122-123):

> We see no reason in the language of the statute for holding that the petitioner's voluntary contribution to the corporation for which he received nothing, albeit the value of his shares was *pro tanto* enhanced, may be regarded as other than a gift. *Bothin Real Estate Co.* v. *Commissioner,* 90 Fed. (2d) 91; *King* v. *United States,* 10 Fed. Supp. 206; affd., 79 Fed. (2d) 453; *Commissioner* v. *Rosenbloom Finance Corporation,* 66 Fed. (2d) 556; certiorari denied, 290 U.S. 692; *Willputte Coke Oven Corporation,* 35 B.T.A. 298. This is no less so because in the corporation's accounting parlance the gift may have been regarded as paid-in surplus, *Bothin Real Estate Co.* v. *Commissioner, supra; Southern Pacific Co.* v. *Edwards,* 57 Fed. (2d) 891, or because the petitioner and the other shareholders derived benefit in the extent to which the augmentation of the corporation assets is reflected in the value of their shares, *Bothin Real Estate Co.* v. *Commissioner, supra; Southern Pacific Co.* v. *Edwards, supra.*

Cf. *Scanlon* v. *Commissioner,* 42 B.T.A. 997, relied upon by the taxpayers. (Br. 22.) There it was held that the transfer of property to a corporation by its *sole* stockholder was not a gift to the corporation. The decision (as we shall observe more fully below) is in possible conflict with the underlying rationale of this Court's opinion in *Bothin Real Estate Co.* v. *Commissioner,* 90 F. 2d 91, and with *Commissioner* v. *Rosenbloom Finance Corp.,* 66 F. 2d 556, certiorari denied,

290 U.S. 692. Furthermore, the Board in the *Scanlon* case was careful to except from the scope of its decision the type of situation in the *Thompson* case (and therefore in the instant case), stating (pp. 999-1000):

> If petitioner were not the sole shareholder a different question would arise. For other shareholders would benefit proportionately from the receipt of the property by the corporation. As to them, particularly members of the transferor's family, there is no reason to disregard the gift theory. *And if to that extent the transfer is a gift there may be no practical method of administering the act save to treat the tax as applying to the whole. Frank B. Thompson,* 42 B.T.A. 121. But no difficulty need disturb us here, since no one but petitioner was interested in either the property transferred or its recipient. (Emphasis supplied.)

And in *Thompson* v. *Commissioner,* decided April 2, 1941 (1941 P-H T. C. Memorandum Decisions, par. 41,208) —involving the same taxpayer and the same issues, but the two years subsequent to the taxable period in litigation in the first *Thompson* case, *supra*—the Board, in deciding those issues consistently with its opinion in the first *Thompson* case, explicitly stated with respect to the intervening *Scanlon* case:

> In that opinion we did not overrule the *Frank B. Thompson* case. Our opinion in that case is dispositive of the questions here presented.[4]

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[4] The two *Thompson* cases were appealed and were disposed of by remands, on February 4, 1942 (C.A. 6th) (30 A.F.T.R.), for action consistent with agreements in compromise entered into by the taxpayer and the Commissioner during the pendency of the appeals.

The taxpayers' reliance upon *Collins* v. *Commissioner,* 1 T. C. 605 (Br. 18), is similarly misplaced. There, in holding that no taxable gift to a corporation resulted from the waiver by its sole preferred stockholder to undeclared dividends in arrear, the Board, expressly contrasting the first *Thompson* case, called attention to the fact that no transfer was involved, since (p. 609) "The 'waiver' was of something not yet done which might never be done."

II

The Transfers Were Gifts to the Corporation Entitling the Taxpayer-Donors to Only One Exclusion for Each Taxable Year

Vorden Farms, Inc., was organized to conduct a farming and agricultural business. It leased the acreage in question to the Vorden Farms partnership. The rent which it received was the source of dividend distributions to the taxpayers and the non-contributing stockholders. There is no suggestion in the record that the corporation did not serve a business purpose, or that it was not doing business. On the contrary, the corporate form of doing business was deliberately employed here to procure the maximum advantage for the taxpayers and the non-contributing stockholders, and they did not regard the corporation as an empty shell. Thus, Stephen F. Heringer, one of the taxpayers, affirmed his understanding that the corporation carried on "business." (R. 34.) Genette Heringer Whisenhunt, a non-contributing stockholder and secretary-treasurer of the corporation, testified that the proceedings at the annual meetings were not "cut and dried." (R. 45.) Frederick J. Heringer, a non-contributing

stockholder and director, testified that at the annual meetings (R. 63):

> We take care of the business which you would normally have in any organization pertaining to the business that we are interested in, such as leases, setting up the dividends, amount of the dividends, and discuss rentals, and so forth.

Donald S. Heringer, also a non-contributing stockholder testified that there were "good organization meetings" and that there were "regular discussions on all topics concerning our business." It is apparent that the corporation was engaged in business activity. Cf. *Kettleman Hills R. S. No. 1* v. *Commissioner,* 116 F. 2d 382 (C. A. 9th), certiorari denied, 333 U. S. 582; *Porter Royalty Pool* v. *Commissioner,* 165 F. 2d 933, 936 (C. A. 6th), certiorari denied, 334 U. S. 83; *Paymer* v. *Commissioner,* 150 F. 2d 334 (C. A. 2d); *Main-Hammond Land Trust* v. *Commissioner,* 200 F. 2d 308 (C. A. 6th).

As the taxpayers concede (Br. 15), acceptance of their position—that if the transfers were gifts at all they were gifts to the non-contributing stockholders—requires ignoring the corporation as a separate and distinct legal entity. But in the circumstances of this case the corporate entity may not be disregarded. The taxpayers and the non-contributing stockholders were of course free to choose any form of enterprise for the conduct of their affairs, but having elected to do business as a corporation, they must accept the attendant tax disadvantages. *Higgins* v. *Smith,* 308 U. S. 473, 477. As observed in *Moline Properties* v. *Commissioner,* 319 U. S. 436, 438-439:

> The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be

> to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity.

See also *Diebold* v. *Commissioner,* 194 F. 2d 266, 270 (C. A. 3d); *Watson* v. *Commissioner,* 124 F. 2d 437 (C. A. 2d); *National Carbide Corp.* v. *Commissioner,* 336 U. S. 422; *Interstate Transit Lines* v. *Commissioner,* 319 U. S. 590; *Commissioner* v. *Court Holding Co.,* 324 U. S. 311; *Porter Royalty Pool Co.* v. *Commissioner, supra; Barber* v. *United States,* 215 F. 2d 663, 667 (C. A. 8th); *Railway Express Agency* v. *Commissioner,* 169 F. 2d 193, 195 (C. A. 2d); *Kaufman* v. *Commissioner,* 175 F. 2d 28 (C. A. 3d). As one authority (Cleary, The Corporate Entity in Tax Cases, 1 Tax L. Rev. 3, 11, 21 (1945-1946)) has stated,[5] the general rule, especially with respect to cases in which the *taxpayers* seek to ignore the corporate entity, is that the corporate entity will not be ignored; the resulting tax disadvantages must be accepted where the taxpayer chooses to do business in corporate form to gain some advantage; and where that form is employed—

> It is difficult, if not impossible, for the taxpayer to compel the Commissioner to ignore corporate entities * * *. Certainly, if a corporation holds

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[5] See also, by the same writer, Use of Subsidiary as an Agent after the National Carbide Corporation Case, Eighth Annual N.Y.U. Institute on Federal Taxation (1950), p. 48.

> property or conducts business or transactions for its own account, the Commissioner can levy taxes on that basis, no matter what the taxpayer's motives for choosing the corporate form may have been or how informally the corporate affairs may be conducted.

There may, of course, be situations in which the corporate entity will be disregarded for tax purposes, where the taxpayer seeks to do so. But, as stated in *Munson S. S. Line* v. *Commissioner,* 77 F. 2d 849, 851 (C. A. 2d) that would require the existence of "exceptional circumstances", which are not present in the instant case. See also *New Colonial Co.* v. *Helvering,* 292 U. S. 435, and *Burnet* v. *Commonwealth Imp. Co.,* 287 U. S. 415.

In *Thompson* v. *Commissioner, supra,* the donor-taxpayer-50 percent stockholder attempted—as the taxpayers here—to (p. 122) "leap over the legal existence and ownership of the corporation". It was held, however, that the transfers were gifts to the corporation, since, as is equally applicable here, (p. 123):

> The corporation is, as the statute expressly says, a "person" * * * and a taxpayer. As such, it is in law separate from the petitioner * * *. It is the donee of petitioner's contributions and the owner thereof in its own right. If it sells the property, the resulting gain or loss comes to it and not to its shareholders * * *. The measure thereof is calculable upon the basis which would have been applicable to the donor * * *. If the donor remains a shareholder of the corporation, his death will result in the testamentary transfer not of the corporation's property but of the petitioner's

shares in the corporation, which, as gross estate, will measure the estate tax.

The decisions of this and of other courts of appeals—in cases involving the determination of the basis of transferred property in order to fix liability for income tax purposes—support the decisions below that the transfers were gifts to the corporation, and not to the non-contributing stockholders. The relevance of those cases to the instant situation stems from their underlying premise that the *transfers of property there made to corporations (by sole or majority stockholders) constituted gifts to the corporations, and not to the stockholders.* In *Bothin Real Estate Co.* v. *Commissioner, supra,* the transferor, who was the sole stockholder of the taxpayer corporation, in 1923 transferred to the taxpayer shares of stock in another corporation. The taxpayer sold part of that stock in 1927, and in 1928 it received approximately $450,000 in cash in liquidation of the remaining stock. With respect to the gain on the liquidation and disposition of the shares, the taxpayer contended that since the transferor was the taxpayer's sole stockholder, any increase in its net worth by reason of the transfer would (as the taxpayers contend in the instant case) be reflected in the book value of his shares of stock; that the enhancement of his shares constituted an adequate consideration for the transfer, foreclosing treatment of the transfer as a gift; that the taxpayer's basis for determining gain was therefore the fair market value of the property at the time of the transfer. This Court, however, held that the transfer was a gift to the corporation (cf. *Scanlon* v. *Commissioner, supra*), thus requiring the use of the cost of the transferred property to the transferor as the basis for determining the tax-

payer's gain or loss. In *Weeks* v. *White,* 77 F. 2d 817 (C. A. 1st), the taxpayer's father organized a corporation in 1919, with the primary purpose of preserving a homestead for the benefit of his heirs. To prevent the homestead from becoming a burden to them, he transferred to the corporation certain securities to insure the upkeep of the property and to meet operating expenses. The father originally owned all but two shares of the stock. However, in 1919, he gave all of the stock to his son (the taxpayer) and to his daughter. In 1928, the corporation paid a dividend in partial liquidation of its capital. In computing his income tax liability for 1928, the taxpayer considered—as part of the cost basis of the stock given to him by his father in 1919—an allocate portion of the cost to his father of the securities which the father had transferred to the corporation. The taxpayer's position rested on the theory that the father's contributions constituted gifts to himself and to his sister, and that he was therefore entitled to use the basis in the hands of the donor at the time the alleged gifts were made. The court disagreed. In language appropriate to the instant case, it said that although the father's contributions were undoubtedly in furtherance of his original purpose, as aforementioned, nevertheless (p. 820):

> If his purpose had been simply to make gifts to his children, there is *nothing to indicate that he would not have done so directly rather than indirectly through the corporation.* * * * the intent of the donor must be the determining factor. Contributions to a corporation cannot be held as a matter of law to be gifts to the shareholders because they may ultimately be beneficially affected. The entity

> of the corporation created by the rather * * * for a definite purpose may not be disregarded. (Emphasis added.)

In *Forrestal, Trustee v. Commissioner,* 41 B. T. A. 1080, James Forrestal organized a personal holding company (Beekman) in 1928, all of the stock of which was issued to him. The taxpayer-trust was created in 1929, and 30 shares of the corporation's stock were transferred to it. In 1932, Forrestal transferred stock of Dillon, Read & Company to the corporation as paid-in surplus. In 1934, Forrestal sold the remaining shares of the corporation to the trust. The corporation was dissolved in 1934. The question was whether Forrestal's contribution to the corporation's paid-in surplus (at a time when he owned only 70 shares of Beekman) served to increase the cost basis of the trust with respect to the 30 shares of Beekman which it owned at that time. The Board, holding that there was no such increase in the taxpayer's basis *because the 1932 transfer was a gift to the corporation*, stated (pp. 1081-1082):

> It does not follow * * * that any portion of the cost of the Dillon-Read shares should be added to the petitioner's basis for gain or loss on its 30 shares of Beekman stock. Forrestal could have contributed some of the Dillon-Read shares directly to the petitioner and the petitioner could have increased its basis on the Beekman shares in turn by contributing the Dillon-Read shares to Beekman. But that was not done. "Contributions to a corporation can not be held as a matter of law to be gifts to the shareholders because they may ultimately be beneficially affected." *Weeks v. White*, 77 Fed. (2d) 817.

See also *Commissioner* v. *Rosenbloom Finance Corp.*, *supra,* and *Wilputte Coke Oven Corp.* v. *Commissioner,* 35 B. T. A. 298, 302-303.

The example in the committee report upon which the taxpayers rely (Br. 17) is not controlling here, and, as the taxpayers themselves have noted (Br. 18), it was not incorporated in later regulations. On its face, a transfer by A to a corporation owned *exclusively* by his children is different from a situation where, as here, A, in effect, has transferred property to a corporation in which his children own 60 per cent of the stock, and he owns the remaining 40 per cent. Cf. *Scanlon* v. *Commissioner, supra,* p. 999. In the committee's illustration, evidence of an intent to make a gift to the children is easily spelled out from the fact that the taxpayer has completely divested himself of all control over, and interest in, the property. The same is not true here, where, after the transfers, the taxpayers still retain a very substantial interest in the corporation. In this circumstance, the question of fact persists—whether the taxpayer-donors intended to make a gift to the corporation, or, *pro rata,* to the non-contributing stockholders —and this was a question for resolution by the trier of the facts. *Wilmington Trust Co.* v. *Helvering,* 316 U. S. 164, 168.

If, as the Tax Court held, the corporation in the instant case was the entity to which the gifts were made, it is clear that the donor-taxpayers are entitled to only one exclusion for each of the years involved. Section 1003(b)(3) of the Internal Revenue Code of 1939, *supra,* applicable to 1948 and 1949, provides that in the case of gifts (other than gifts of future interests in property) made to any persons, the first $3,000 of such

gifts to such person shall not be included, in computing the tax laid upon net gifts made during the year. Section 3797(a)(1) of the 1939 Code, *supra,* plainly defines the term "person" as meaning, among other things, a corporation. Furthermore, even if we assume, without conceding, that the taxpayers in fact intended to make gifts to the non-contributing stockholders, and not to the corporation, they would have been gifts of future interests, and no exclusions would have been allowed. Section 86.11, Treasury Regulations 108, defines a "future interest" to include, among other things, an interest which is limited to commence in use, possession, or enjoyment, at some future date or time. See *United States* v. *Pelzer,* 312 U. S. 399; *Ryerson* v. *United States,* 312 U. S. 405; and *Helvering* v. *Hutchings,* 312 U. S. 393. The term "future interest" is not limited to its meaning in the law of property. As stated in *Commissioner* v. *Wells,* 132 F. 2d 405, 407 (C. A. 6th):

> In considering this question, it is necessary to put aside conceptions of "estates in future" as understood by Blackstone and the classic commentators on the common law. For future estates, as the term is used in the statute, are not to be understood as interests similarly designated in the law of conveyancing. They are, rather, interests in land or other things, in which the privilege of possession or of enjoyment is future and not present * * *.

And as this Court observed in *Fisher* v. *Commissioner,* 132 F. 2d 383, 385:

> The Treasury Regulations and committee reports concerned * * * merely declare that possession or enjoyment must commence in the future.

See also *Hutchings* v. *Commissioner,* 1 T. C. 692.

The non-contributing stockholders did not have the present right to the use, possession or enjoyment of the properties transferred to the corporation by the taxpayers. Full ownership and control of the acreage contributed by the taxpayers was in the corporation. True, the non-contributing stockholders were entitled to receive dividends from corporate earnings derived from the rents which they, as partners of Vorden Farms, paid to the corporation, and they could expect to receive part of the assets of the corporation when and if there was a distribution in liquidation. But these were obviously interests limited to commence in use, possession, or enjoyment at some future date or time, and were therefore future interests within the meaning of Section 1003(b).

The taxpayers' reliance upon *Helvering* v. *Hutchings, supra,* is misplaced. That case involved a trust for the benefit of the taxpayer's children. True, in holding that the number of exclusions for gift tax purposes was there controlled by the number of the beneficiaries, the Supreme Court stated (p. 396):

> A gift to a trustee reserving to the donor the economic benefit of the trust or the power of its disposition, involves no taxable gift. It is only upon the surrender by the donor of the benefit or power reserved to himself that a taxable gift occurs, *Estate of Sanford* v. *Commissioner,* 308 U. S. 39; *Rasquin* v. *Humphreys,* 308 U. S. 54, and it would seem to follow that the beneficiary of the trust to whose benefit the surrender inures, whether made at the time the trust is created or later, is the "person" or "individual" to whom the gift is made.

Significantly, however, the Court explained (p. 36) that in common understanding and usage of language "One does not speak of making a gift to a trust rather than to his children who are its beneficiaries." By way of contrast, however, the concept of a corporation as a separate entity, distinct from its stockholders and in complete control of the property in which it is vested with full legal and equitable title, is firmly entrenched in our jurisprudence. Consequently, as observed in *Thompson, supra,* p. 124, "the very doubt which [before *Hutchings*] * * * affected the question as to trusts strengthens the conclusions that a gift to a corporation may not be treated as a group of gifts to its shareholders." As we have already noted, the corporation here was not a sham, and it may not be disregarded. The taxpayers' surrender of benefit and power with respect to the acreage here involved was to the corporation, as such, and not to the non-contributing shareholders. Furthermore, even if it is assumed, *arguendo,* that *Hutchings* supports the view that a gift to a corporation is a gift to its stockholders, the gifts must be of present interests. *Hutchings* explicitly avoided any consideration of the question whether the gifts to the trust beneficiaries there were of future interests, since that question was "not presented by the petition for certiorari." (P. 398) In the instant case, as we have said above, if the transfers were gifts to the non-contributing stockholders, they were gifts of future interests.

III

The Value of the Gifts Was the Full Value of the Acreage Conveyed

On the hypothesis that the transfers of the property were gifts to the corporation, the taxpayers divested

themselves, in favor of the corporation, of full ownership and control over the acreage (except such control as any minority stockholders would have with respect to any property indisputably owned by the corporation and even derived by it from a source other than its stockholders). It follows, then, that the value of the gifts to the corporation was the full measure of its value in the hands of the transferors. This is no less so because the taxpayers "derived benefit in the extent to which the augmentation of the corporation assets is reflected in the value of their shares." *Thompson* v. *Commissioner, supra,* p. 123. See also *Bothin Real Estate Co.* v. *Commissioner, supra; Weeks* v. *White, supra,* p. 820. The taxpayers' argument to the contrary is valid, admittedly, only on the assumption that the corporation is to be regarded as nothing more than a mere (Br. 21) "mechanical vehicle to effect the transfer of only 60% of the value of the land to the eleven individual shareholders." But Vorden Farms, Inc., was a bona fide corporation voluntarily organized as a suitable means of doing business and accomplishing the ends sought by the taxpayers and the non-contributing shareholders. Nothing in the record suggests that the taxpayers could not have conveyed 60 percent of the acreage directly to the eleven children. Cf. *Weeks* v. *White, supra,* p. 820. But that was not done, and a taxpayer does not escape tax liability on a taxable transaction merely because he might have chosen a non-taxable method. As stated in *Founders General Co.* v. *Hoey,* 300 U. S. 268, 275:

> It is suggested that * * * the taxpayer might have attained his ultimate purpose by a form of transaction which would not have subjected him to

the tax. The suggestion, if true, furnishes no reason for relieving him of tax when, for whatever reason, he chooses a mode of dealing within the terms of the Act. * * * To make the taxability of the transaction depend upon the determination whether there existed an alternative form which the statute did not tax would create burden and uncertainty.

CONCLUSION

The decisions of the Tax Court are correct and should be affirmed.

Respectfully submitted,

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